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FISCAL IMPACT STATEMENT

LS 7320 | **NOTE PREPARED:** Jan 24, 2005
BILL NUMBER: HB 1006 | **BILL AMENDED:**

SUBJECT: Economic Development Tax Incentives.

FIRST AUTHOR: Rep. Borror | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: *Depreciable Personal Property:* The bill changes the minimum personal property tax depreciation floor from 30% to 15%.

Property Tax Abatements: The bill makes permanent the authority of local designating bodies to grant certain tax abatements. The bill allows a designating body in any county to grant tax abatement for new logistical distribution equipment and new information technology equipment. The bill also allows tax abatements to be granted after December 31, 2005.

Sales Tax Exemption for R & D Equipment: The bill exempts purchases of research and development equipment from Sales Tax.

Single Factor Apportionment: The bill provides that, for purposes of the Adjusted Gross Income Tax, business income is apportioned based only on the sales factor.

EDGE Credit: The bill changes the qualifications for an Economic Development for a Growing Economy (EDGE) Tax Credit to retain existing jobs in Indiana.

Venture Capital Investment Tax Credit: The bill increases the maximum amount of Venture Capital Investment Tax Credits that may be granted in a year from $10,000,000 to $20,000,000.

TIF: Repeals a provision restricting the time in which a statement of benefits for a tax abatement may be approved. Extends the deadline for creation of tax increment finance (TIF) areas from December 31, 2005, to December 31, 2015.

Effective Date: July 1, 2005; January 1, 2006.

Explanation of State Expenditures: *Depreciable Personal Property:* The state pays Property Tax Replacement Credits (PTRC) in the amount of 60% of school general fund levies attributable to all property and 20% of the portion of all operating levies (including the remaining 40% of the school GF levy) that are attributable to real property and non-business personal property. Homestead credits are paid by the state in the amount of 20% of the net property tax due on owner-occupied residences.

The tax shifts from business personal property to other property in the bill would cause the state's expense for regular PTRC and Homestead Credits to increase. The additional state expense is estimated at $4.9 M in FY 2007 (partial year) and $14.9 M in FY 2008. PTRC and Homestead Credits are paid from the Property Tax Replacement Fund (PTRF). These credits are paid from the state General Fund if insufficient balances are available in the PTRF.

Single Factor Apportionment: The transition to a single-factor sales apportionment formula to determine the Indiana Adjusted Gross Income Tax will affect the administration of the tax. The Department of State Revenue will incur additional expenses to revise tax forms, instructions, and computer programs to incorporate the change.

EDGE Credit: The bill could potentially broaden eligibility and expand the applicant pool for EDGE credits relating to job retention projects. This may increase the number of applications for EDGE credits and the number of EDGE credits awarded annually, creating additional administrative demands on the Indiana Economic Development Corporation (IEDC). While under current statute the Indiana Department of Commerce (IDOC) provides administrative support to the EDGE Board, the IDOC is abolished on July 1, 2005, and all economic development functions are to be transferred to the IEDC. The November 4, 2004, state staffing table indicates that the Indiana Department of Commerce (IDOC) has 31 vacant full-time positions, including regional office positions. To the extent that these vacant positions are transferred to the IEDC on July 1, 2005, they could potentially be utilized to assist in meeting these demands.

Explanation of State Revenues: *Depreciable Personal Property:* The state levies a tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds. The annual revenue reduction under this proposal is estimated at about $43,000 in FY 2007 and $86,000 in years following.

Property Tax Abatements: The state levies a small tax rate on property for State Fair and State Forestry. If there is an increase in investment because of the changes in this bill, the new property would, at some point, be placed on the tax rolls and the State Fair and State Forestry funds would receive increased revenues. If the investment would have been made with or without the abatement, then increased revenues to the State Fair and State Forestry funds would be foregone until the property is placed on the tax rolls. Any change in the amount granted for abatements would change the amount received from this tax.

Sales Tax Exemption for R & D Equipment: The bill exempts certain research and development (R&D) equipment sales from the state's 6% Sales Tax. The exemption is estimated to reduce Sales Tax revenue by $23 M to $57 M in FY 2006, and approximately $25 M to $63 M in FY 2007.

The estimate above is based on data obtained from the National Science Foundation (NSF) that describes the total value of industrial research and development performed in Indiana through CY 2000. Based on past R&D expenditures and adjusting for historical growth, it is estimated that in FY2006, Indiana firms will expend a total of approximately $2,944 M on R&D in Indiana. In FY 2007, these expenditures are expected to increase to $2,984 M. Using NSF information on how R&D funds are spent, it is estimated that approximately 14% to 35% of Indiana R&D expenditures would be subject to the state's Sales Tax.

Single Factor Apportionment: The proposed change in the apportionment formula is likely to decrease Indiana Corporate Income Tax revenues. The estimation of the magnitude of the decrease in revenues is indeterminable at this time.

The apportionment formula is used to determine Indiana Adjusted Gross Income for corporations whose income is derived from sources both within and outside Indiana. Currently, a three-factor apportionment formula is used to determine Indiana Adjusted Gross Income. The formula includes property, payroll, and sales (also called receipts) to allocate business income to the state. The sales factor is double weighted. The current formula is shown below.

$$\left[\frac{\text{Indiana Property}}{\text{Total Property}} + \frac{\text{Indiana Payroll}}{\text{Total Payroll}} + 2*\left(\frac{\text{Indiana Sales}}{\text{Total Sales}}\right)\right] \div 4$$

The bill would eliminate the property and payroll factors in the apportionment formula and the double weight of the sales factor. A corporation's adjusted gross income would be determined by a single-factor formula which measures Indiana sales as a proportion of total sales in the United States. The new formula is shown below.

$$\frac{\text{Indiana Sales}}{\text{Total Sales}}$$

Corporate income taxes are distributed to the General Fund and the Property Tax Replacement Fund. In FY 2004, $443.1 M was collected in corporate Adjusted Gross Income Taxes.

EDGE Credit: The bill: (1) changes the average compensation requirement for businesses seeking EDGE credits for job retention projects; (2) lowers the the employment requirement for businesses seeking EDGE credits for job retention; and (3) changes the average wage standard to be considered by the EDGE Board in determining the EDGE credit amount for a business proposing a project to create jobs. These changes could potentially increase the revenue loss from EDGE credits. However, the magnitude of this loss is indeterminable.

In 2003, the EDGE Board approved approximately $28.8 M in new credits for job creation to be used over a period of years. The credits were awarded for 16 projects expected to create 6,823 new jobs. The EDGE Board also approved $2.0 M in new credits for job retention, also to be used over a period of years. The credits were awarded for 2 projects expected to retain 2,450 jobs. From 1994 to 2003, EDGE credits for job creation were approved for 114 projects. During those years, approximately $132.4 M in EDGE credits for job creation were made available, with the total amount of credits certified so far equal to about $81.3 M. Approximately $38.2 M in EDGE credits for job creation were available for approved projects in tax year 2003. EDGE credits for job retention were awarded for the first time in 2003.

Venture Capital Investment Tax Credit: The bill would allow for an additional $10.0 M in credits under the Venture Capital Investment Tax Credit to be certified during tax years 2006, 2007, and 2008. This could potentially increase the annual fiscal impact of the credit from $10 M to $20 M beginning in FY 2007.

The credit is a nonrefundable tax credit equal to the lesser of: (1) 20% of qualified investment capital (debt or equity capital) provided to a qualified Indiana business during a calendar year; or (2) $500,000. The tax credit is allowed for venture capital investment made from January 1, 2004 to December 31, 2008. In 2004, 42 companies were designated as qualified to receive venture capital for which the investors could receive tax credits. Approximately $3.6 M in tax credits were approved for these investors. Under current law, a taxpayer may claim the credit against the State Gross Retail and Use Tax, Adjusted Gross Income (AGI) Tax, Financial Institutions Tax, or Insurance Premiums Tax liability.

TIF: The state levies a small tax rate on property for State Fair and State Forestry. Any change in the amount granted for TIFs would change the amount received from this tax. If there is an increase in investment because of the changes in this bill, the new property would, at some point, be placed on the tax rolls and the State Fair and State Forestry funds would receive increased revenues. If the investment would have been made with or without the TIF, then increased revenues to the State Fair and State Forestry funds would be foregone until the property is placed on the regular tax rolls.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Depreciable Personal Property:* Under current regulations, the total value of a taxpayer's depreciable property located in the same tax taxing district must be at least 30% of the total cost of the property. This is known as the 30% valuation floor. This bill would change the floor to 15% beginning with March 1, 2006 assessments for property taxes paid in CY 2007.

The reduction of the assessment floor would reduce the assessed value (AV) of personal property which would shift part of the tax burden from personal property taxpayers to all property taxpayers. An examination of data from property tax returns with over $150,000 in AV suggests that about 11.2% of the AV of depreciable assets would be lost. This AV reduction would cause an increase in the gross tax rate of about $0.0400. Statewide, net tax on business personal property would be reduced by an estimated $85 M or 8.3%. Net tax on real property would increase by an estimated $71 M or 1.4%. As a subset of all real property, net tax on homesteads would increase by an estimated $19 M or 1.1%. The $14M difference between the personal property reduction and the real property increase would be paid by the state as PTRC and Homestead credit. The reduction in personal property AV would also reduce the tax generated for cumulative funds.

Property Tax Abatements: Under current law, real property, new manufacturing equipment and new research and development equipment may qualify for property tax abatements. The abatements are available for up to ten years. Currently, no new abatements can be granted after December 31, 2005.

This bill also would allow abatements for new "logistical distribution equipment and new "information technology (IT) equipment if installed after December 31, 2005, in an economic revitalization area of a county containing an interstate highway. Current law concerning these abatements applies only to equipment installed before January 1, 2006, and only for certain counties containing I-69.

Logistical distribution equipment would consist of racks, scanners, separators, conveyors, forklifts, moving equipment, packaging equipment, sorting and picking equipment, and software.

IT equipment would include equipment and software used in the fields of information processing, office automation, telecommunication facilities and networks, informatics, network administration, software development, and fiber optics.

This bill eliminates the December 31, 2005, deadline for abatements for new logistical distribution and IT equipment to be granted, effectively allowing these provisions to be granted any time in the future and in other counties. If there is an increase in development because of the continued use of these abatements, the new property would, at some point, be placed on the tax rolls. This could help spread the property tax burden and could possibly reduce some tax rates.

However, if one assumes that the investment would be made with or without the abatement, an increase in abatements (ERAs) could also cause a delay in the shift of the property tax burden from all taxpayers to the owners of the new property until the property is placed on the tax rolls. In all cases, the granting of an abatement is a local decision.

The impact would depend on the value of new abatements that might be granted after CY 2005. The following chart shows the total abatements for the last 10 years for real and personal property.

Year	**Real**	**Personal**	**Total**	**Increase**
1994	$41,790,975	$54,579,109	$96,370,085	
1995	42,660,544	44,913,061	87,573,605	($8,796,480)
1996	39,409,092	66,760,681	106,169,772	18,596,168
1997	41,483,134	49,280,601	90,763,735	(15,406,038)
1998	43,312,527	43,532,906	86,845,433	(3,918,302)
1999	47,739,446	49,989,013	97,728,459	10,883,026
2000	50,877,703	70,955,197	121,832,900	24,104,441
2001	57,247,336	94,062,035	151,309,370	29,476,471
2002	65,621,529	102,594,325	168,215,854	16,906,484
2003	59,113,642	154,181,896	213,295,539	45,079,685

The average annual increase over the last five years has been $25.3 M.

TIF: Under current law, TIFs are granted for up to 50 years, and proceeds may be used to:

1. Pay debt service on obligations incurred for the financing of redevelopment in the allocation area;
2. Deposit funds into a debt service reserve to pay bonds;
3. Pay debt service on bonds used to pay for local improvements in or serving the allocation area;
4. Pay premiums on early bond redemptions;
5. Make lease payments;
6. Reimburse the local unit for the cost of making local improvements;
7. Reimburse the local unit for rent paid by the unit for a building or parking facility in or serving the allocation area;
8. Pay a PTRC-like credit to taxpayers in the allocation area;
9. Pay expenses incurred by the redevelopment commission for public improvements in or serving the allocation area; and
10. Reimburse public and private parties for expenses in training employees of certain industrial facilities.

Currently, no new TIFs can be created after December 31, 2005.

This bill extends to December 31, 2015, the deadline for TIFs to be granted, effectively allowing these provisions to be granted for 10 more years. If there is an increase in development because of this proposal, the assessed value of the new property would be included in taxing units' certified valuations when the TIF area expires. This could (1) eventually help spread the property tax burden and potentially reduce tax rates for most funds and (2) eventually increase revenues in cumulative and capital projects funds. However, if one assumes that the investment would be made with or without the TIF, then TIF allocation (or capture of the new assessed value) would delay the rate reductions and cumulative /capital projects fund revenue increases. In all cases, the granting of a TIF is a local decision.

The impact would depend on the value of new TIFs granted after CY 2005. The following chart shows the total TIFs for the last 10 years.

Year	TIFs	
	Total	Increase
1994	$23,116,487	
1995	27,555,225	4,438,738
1996	32,003,233	4,448,008
1997	31,998,229	(5,004)
1998	38,078,710	6,080,481
1999	40,528,120	2,449,410
2000	51,193,949	10,665,829
2001	29,191,747	(22,002,202)
2002	44,379,676	15,187,929
2003	29,950,248	(14,429,428)

State Agencies Affected: Indiana Economic Development Corporation; Department of Natural Resources; Fair Board; Department of State Revenue; Department of Local Government Finance.

Local Agencies Affected: County auditors.

Information Sources: Indiana Department of Commerce, *2003 EDGE Annual Report*, March 31, 2004; *2003 EDGE for Retention Annual Report*, March 31, 2004. Lynette Curtis, Indiana Department of Commerce, 317-232-8898. Local Government Database. National Science Foundation, *Survey of Industry Research and Development*. Department of State Revenue*, Indiana Corporate Adjusted Gross Income Tax Booklet*.

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